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SUBJECT: Argentina Economic and Financial Weekly for the week ending
August 25, 2006

Weekly Highlights

- GOA announces nuclear expansion program.
- Minister of Economy Felisa Miceli proposes IMF structural reforms.
- GOA primary surplus reaches ARP 2.09 billion in July -- in line with market expectations.
- July industrial production index up 8.8 percent y-o-y.
- July trade surplus of USD 940 million -- below market expectations.
- Government Confidence Index down 5 percent m-o-m in August.
- Commentary of the Week: "In the shadow of Gath & Chaves"

GOA announces nuclear expansion program.

1. Argentina announced that it would expand its nuclear power program and reactivate a dormant uranium enrichment facility. The announcement described four pillars upon which Argentina's enhanced nuclear energy capabilities would rest: The GOA plans to finish construction of the approximately 700MW Atucha II nuclear reactor in Buenos Aires province; start design and feasibility studies on a possible fourth reactor (Argentina currently has two functional nuclear power plants); extend the life of the Embalse reactor in Cordoba Province, which had been scheduled to cease operations in 2011; and reopen a uranium enrichment facility in the town of Pilcaniyeu. Planning Minister De Vido also said that the GOA would resume production of heavy water at a plant in Neuquen Province, with a goal of producing 600 tons in three years.

Economic Minister Felisa Miceli proposes IMF reforms.

2. On August 22, during a GoA-sponsored seminar, Economic Minister Felisa Miceli previewed IMF reform proposals the GOA plans to present in more detail to Mercosur member nations. She hopes to develop a common Mercosur position prior to the IMF's upcoming Singapore annual meeting. Proposed measures included:
- A return of the IMF to a more "traditional" lender of last resort role, including by providing "automatic" credit lines and on-request

loans in case of crises;
- Provision of IMF collateral to support member country bond issues;
- A reexamination of the IMF quota determination formula.

13. Miceli also noted that Argentina will not support any increase in member fees to finance the IMF. She lauded Argentina's fiscal and trade surpluses, calling them the result of a learning process after 15 years of crises without clear assistance from the IMF.

GOA primary surplus reaches ARP 2.09 billion in July -- in line with market expectations.

14. July GOA's primary surplus reached ARP 2.09 billion, up 13.6 percent y-o-y from ARP 1.84 billion in July 2005. Primary spending remains high: Capital spending jumped 37 percent y-o-y and non-interest current expenditures were up 28 percent y-o-y. Current expenditures are expected to continue their growing trend given recent hikes in public wages and pensions. On a 12-month rolling basis, the July primary surplus totaled 3.5 percent of GDP, unchanged from June. The BCRA consensus survey forecasts a primary surplus of ARP 21.7 for 2006.

July industrial production index up 8.8 percent y-o-y.

15. The industrial production index rose 8.8 percent y-o-y in July, above market expectations of 8.3 percent and in line with the prior month's 8.9 percent increase. During July, the fastest growing sectors included automobile production (+33.9 percent), tobacco production (+16.8 percent), non-metallic minerals (+13.7 percent), oil refining (+11 percent) and printing (+8.5 percent). The index

increased 4.9 percent m-o-m non-seasonally adjusted and increased 0.3 percent m-o-m seasonally adjusted. The BCRA consensus survey forecasts a 7.1 percent industrial production growth for 2006 -- above last month's forecast of 6.9 percent.

16. The industry-wide capacity utilization index reached 72.7 percent in July, up slightly from 72 percent in July 2005. Sectors with the highest capacity utilization rates were included metal-based industries (93.3 percent), oil refining (93 percent) and textiles (87.4 percent). Sectors with the lowest capacity utilization rates included auto production (55.1 percent), non-metallic minerals (63.1 percent) and metal-mechanical excluding cars (65 percent).

July trade surplus of USD 940 million -- below market expectations.

17. The July trade surplus reached USD 940 million, below market expectations of USD 1.1 billion. Exports increased 6 percent y-o-y to USD 3.8 billion, following 12 percent y-o-y growth in June, with an increase of 9 percent in price, partially offset by a 3 percent decrease in quantity. Exports were driven by increases in industrial goods (+21 percent y-o-y), agribusiness (+11 percent y-o-y) and fuel and energy (+6 percent y-o-y), while primary goods decreased 22 percent y-o-y. Imports increased 21 percent y-o-y to USD 2.9 billion, with increases in both price (+2 percent) and mainly in quantity (+19 percent). Imports were driven by increases in capital goods (+32 percent), consumer goods (+26 percent), passenger vehicles (+23 percent), accessories for capital goods (+22 percent), fuel and oil (+17 percent) and intermediate goods (+14 percent). The accumulated trade surplus reached USD 6.9 billion during the first seven months of 2006 and according to the BCRA consensus survey, it is expected to narrow to USD 10.6 billion by the end of the year, compared with USD 11.3 billion in 2005.

2007 national budget could include higher expenditures.

18. On August 21, El Cronista reported that the 2007 national budget may include expenditures of more than ARP 130 billion. One of the

major causes for the expected rise in expenditures is a Supreme Court ruling dictating that the GOA should include pension adjustments in the 2007 budget (at an estimated cost of ARP 5.2 billion annually). The 2007 budget is expected to be sent to Congress on September 15. In 2006, budgeted expenditures totaled ARP 93.7 billion but, according to local consultants, could reach more than ARP 110 billion by the year end.

Government Confidence Index down 5 percent m-o-m in August.

¶9. The Government Confidence Index decreased 5 percent m-o-m in August to 2.41 points, 0.18 below the average during the Kirchner administration and well above the 1.2-point level in May 2003 when Kirchner took office. Confidence in the GOA's ability to solve citizens' problems decreased 5 percent m-o-m, but remained the single factor generating the highest level of confidence. Public opinion about the honesty of GOA officials and the efficiency of public spending increased 3 percent and 1 percent m-o-m respectively, while the perception of the GOA's general performance decreased 9 percent m-o-m. The index slightly fell 0.4 percent y-o-y. [The Government Confidence Index is a survey-based index prepared by Di Tella University. It varies from zero to five points and seeks to measure public opinion of GOA's general performance, efficiency of public spending, honesty of GOA officials and the government's ability to solve problems.]

Unemployment officially fell to 10.4 percent in Q2 of 2006.

¶10. On August 22, INDEC (National Bureau of Statistics) officially announced that the unemployment rate dropped to 10.4 percent in the second quarter of 2006, vs. 11.4 percent in Q1 of 2006 and 12.1 percent in Q2 of 2005. This figure was in line with President Nestor Kirchner's preliminary announcement made July 27. The GOA

projects unemployment will be below 10 percent by the end of the year for the first time in 13 years, while analysts in a Reuters' survey expect the rate to fall to 9.3 percent by December. INDEC also publishes the unemployment rate that results from considering as unemployed those receiving State Head of Household benefits, which reaches 12.8 percent.

BCRA rolls over maturities and decreases rates for Lebacs and Nobacs.

¶11. The BCRA received ARP 1.3 billion in bids at its August 22 Lebac and Nobac auction, and no Lebacs or Nobacs came due during the week. It accepted ARP 697 million in Lebac bids and ARP 288 million in Nobac bids. The yield on the 154-day Lebac decreased from 8.39 percent to 8.30 percent and the yield on the 238-day Lebac decreased from 9.95 percent to 9.90 percent. The yield on the longest term instrument, the 350-day Lebac, dropped from 11.75 percent to 11.65 percent. Lebacs for maturities of more than 350 days were withdrawn because of the BCRA's decision not to validate the yield proposed by the market. The spread on the one-year Nobac decreased from 1.30 percent to 1.15 percent and the two-year Nobac from 2.98 percent to 2.68 percent. The Badlar rate (the base rate for Nobacs) is currently at 9.4 percent. Rates fell for the fourth consecutive week due to strong market demand and the BCRA's decision to accept more Lebacs rather than Nobacs bids.

Peso unchanged against the USD this week, closing at 3.10 ARP/USD.

¶12. The peso depreciated slightly versus the USD after remaining flat most of the week, closing at 3.10 ARP/USD. The BCRA is still not reporting daily transactions in the dollar market, reducing market transparency and depriving investors of useful information. The peso exchange rate has depreciated 1.6 percent since the beginning of the calendar year. The BCRA's reserves stood at USD 27.2 billion as of August 23, and have increased USD 8.7 billion, or 47 percent, since the GOA prepaid its entire IMF debt on January 2.

Commentary of the Week: "In the shadow of Gath & Chaves", by Ricardo Esteves, from an editorial printed in La Nacion on July 25.

¶13. On the corner of Florida and Peron, where once stood the symbol of Argentine business -- the department store Gath & Chaves -- today hosts a flagship of Chilean expansion and commerce: Falabella.

¶14. This is good news, because Falabella is an efficient provider of goods at convenient prices and helps meet the demand of Argentine consumers.

¶15. Seen from a business perspective, it is a painful reminder of the slowdown of the Argentine business sector, bothered by systems and models that ignore businesses and the accumulation of capital. This process explains why Argentina today has a poverty rate of 32 percent, while Brazil's is only 22 percent. Just thinking of this a few decades ago would have been the result of a sick mind.

¶16. If Buenos Aires was 30 or 40 years ago the mecca to which Chileans flocked in search of high quality articles that they couldn't find in their own country, today it is where they come for the bargains a favorable exchange rate provides.

¶17. In the case of Falabella, by basing its business in a country with stable policies, it can develop a supply structure around the world and grow in other markets

¶18. If a market suddenly contracts, as tends to happen in Argentina, this obliges local firms to discontinue foreign operations, break their contracts and lose ground. The Chileans, on the other hand, can maintain a flow of international purchases based on a constant level of consumption in Chile.

¶19. The stability of economic policies is a fundamental condition for the financing of any enterprise. In our country, however, changes are typically 180 degrees. We move to the beat of immediate

political interests, without thinking in the long term. And despite having the largest business structure in Latin America in the middle of the 20th century, today it is insignificant compared with that of Chile, Brazil or Mexico

¶20. Hampered by laws and adverse conditions, businesses have known only retreat in the past decades. These negative factors also affect foreign investment, which has been insufficient to make up for the deteriorating state of the national business sector.

¶21. The lack of businesses - national and foreign - is at the root of high poverty rates. There is poverty because there is a lack of employers. That why it is so fundamental for the country to recreate favorable business conditions that are based on profitability and trust in the laws and institutions. It is also essential to protect small and medium enterprises, so that they are started, grow, and one day turn into large companies. If not, there will be fewer national enterprises and their owners will become renters.

¶22. Argentine businesses must compete not only with multinational corporations, but with businesses from other Latin-American countries, which don't repudiate their debts and therefore can finance themselves in the long run and at reasonable interest rates.

Although no one in his right mind would question the right of workers to improve their working conditions, changes must be made in a way that does not discourage business ventures, so that entrepreneurs grow and can employ more and more people. Although workers may achieve new prerogatives, unemployed and underemployed would remain excluded from the system.

¶23. The insensitivity toward businesses' needs and the lack of strategic vision caused the country to squander sectors as its vital cultural industries: motion pictures and publishing were among the most important in Latin America.

¶24. It is as if the country renounced businesspeople, globalization and the future, without realizing that it still possesses the human

resources (so long as the effects of its old, competitive, education system lasts) to contribute in the global economy provide a more decent standard of living to its citizens, reducing the number of impoverished people

¶25. We must have faith in our own strengths and faith in the future. Paradigms are shifting, leaving past arguments without backing.

¶26. Right in the cradle of untamed capitalism, one of those paradigm shifts came about that will determine the future.

¶27. The two richest men in the world, Bill Gates and Warren Buffet, whose fortunes sum to tens of billions of dollars - together equivalent to half of Argentina's GDP in a year - have decided to donate a good part of their fortunes to humanitarian foundations. Their money goes not exactly to construct museums or hospitals in the United States, their home country, but rather to fight against the sickness and catastrophes devastating Africa, and to promote its development.

¶28. If the partnership between opportunities and entrepreneurs has committed abuses and blunders in the international field hand in hand with their political leaders, the action of its greatest entrepreneurial leaders vindicates them. (Note: We reproduce selected articles by local experts for the benefit of our readers. The opinions expressed are those of the authors, not of the Embassy. End Note.)

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